

**Minute of the thirty-seventh meeting of the Water Industry Commission
for Scotland**

6 May 2008

Present:

Sir Ian Byatt (Chairman)
Professor David Simpson (Deputy Chairman)
Professor John Banyard
Dr Michael Brooker
Mr Charles Coulthard
Mr Alan Sutherland (Chief Executive)

In attendance:

Mrs Katherine Russell (Director of Corporate Affairs)
Mrs Donna Very
Mr Richard Khaldi and Mr Cameron McKean (Section 5)
(Analysts)
Mr Ian Tait (Director of Investment) (Section 6)
Mr John Simpson (Director of Analysis) (Section 7)
Mr Craig Mackenzie (Analyst) (Section 7)

Chairman's opening remarks

The Chairman welcomed everyone to the meeting and thanked them for attending.

1. Apologies for absence

None

2. Minute of previous meeting and review of action points

2.1 Minute of last meeting (03/08)

The Commission agreed that the minute was an accurate account of proceedings.

2.2 Review of action points (AP03/08)

The Commission were updated on action points from the previous meeting.

The Commission noted that a dinner had provisionally been arranged with the CMA Board on 5 August and requested that this date be changed as the Commission will not meet in August.

3. Update on current issues

- Charles Coulthard reported that he had attended the Scottish Competition Law Forum on 11 April. John Fingleton, Chief Executive of the Office of Fair Trading (OFT), gave an informative speech on the OFT's future approach to competition cases and explained how they hoped to build stronger links with government departments in the future.
- The Chief Executive updated the Commission on the recruitment of a senior engineer. After broadening the remit of the role to include competition, several good candidates had now expressed an interest.
- The Chief Executive reported that he had recently met with Professor Martin Cave and colleague, Alex Skinner. Professor Cave is conducting a review of competition in the English and Welsh water industry. The Chief Executive updated Professor Cave on his experience including the initial findings on the costs and benefits of introducing competition to the Scottish industry.
- The Chief Executive also reported that the office had co-hosted with Utility Week two seminars in Edinburgh and Glasgow. These events were designed to explain how competition could benefit business customers. Both events were well attended.
- The Chairman reported that he had given a talk to the Regulatory Policy Institute in Oxford on whether the Scottish model is exportable. The Chairman advised that he was due to have dinner with Water UK on 15 May. He also noted that the European Policy Forum are having a seminar on 18 June to which the Chairman and Chief Executive are to be invited. Professor Martin Cave, the speaker, will outline the initial stage of his review of competition in England and Wales.
- The Chairman also reported that he had held meetings with the Western Islands Council, Highland & Islands Enterprise, Alasdair Allan, MSP for the Western Isles, Highland Council, Aberdeen City and Aberdeenshire Council.

He was pleased to find that development constraints no longer appeared to be an issue in these areas.

- The Chairman also had an introductory meeting with the new Chief Executive of Scottish Water, Richard Ackroyd, and its Chairman Ronnie Mercer. They discussed the importance of investment projects being signed off as fit for purpose by the quality regulators (DWQR and SEPA).
- The Director of Corporate Affairs confirmed that the regular liaison meetings with Scottish Water's Regulation Manager, Belinda Oldfield were progressing well.

3.1 Update on the Central Market Agency (CMA)

The Commission noted the written update on the work of CMA submitted by its Chief Executive, Dr Jeremy Atkinson who unfortunately was unable to attend.

The Commission noted that it looked forward to meeting with the CMA's Board in the near future to discuss working practices between the two organisations.

4. Corporate Affairs

4.1 Update on the office workplan and strategy for the price review (CP58/08)

The Commission noted the update to the office's workplan.

4.2 Update on framework contracts (CP59/08)

The Commission noted this update.

Action point: Director of Investment to provide further detail on projects being undertaken by Arup.

4.3 Update on internal audit tender (CP60/08)

The Commission noted that there was a potential conflict of interest with one of the tenders for the office's internal audit contract. The Commission noted that whilst Price Waterhouse Coopers acted as external auditors to Scottish Water, they did so on appointment by Audit Scotland.

The Commission therefore agreed with the Audit Committee Chairman's view that there would be no conflict of interest in appointing Price Waterhouse Coopers as internal auditor.

4.4 Draft Annual Report 2007/08 (CP61/08)

The Commission approved this paper subject to drafting comments. The Commission agreed to delegate authority to the Chief Executive to incorporate these comments and finalise the document.

Action point: Chief Executive to finalise document.

4.5 Scottish Water's new Code of Practice (CP62/08)

The Commission approved this paper.

Action Point: Director of Corporate Affairs and Customer Service to write to Scottish Water and inform them of the Commission's approval.

5. Competition

5.1 Update on Licence Providers (CP63/08)

The Commission noted this document.

5.2 Update on Schedule 3 (CP64/08)

The Commission noted this update. The Commission noted that there were potential issues arising from six outstanding Schedule 3 agreements.

The Commission requested that further legal counsel be sought, and that they be updated by end September 2008.

**Action Point: Further legal advice to be sought.
Chief Executive to meet with Scottish Water to discuss referral to OFT.**

5.3 Update on Section 29e (CP65/08)

The Commission noted the update on progress with enhancing the process for applying for departures from Scottish Water's wholesale charge scheme under Section 29e of the Water Services (Scotland) Act 2005. The Commission agreed to reduce the materiality threshold for Section 29e applications from £1 million to £250,000. This figure will be kept under review.

5.4 Update on Communication Strategy (CP66/08)

The Commission noted this paper and congratulated the Director of Corporate Affairs on her work.

6. Investment

6.1 Oral update on investment delivery

6.2 Progress on investment delivery (CP 67-08)

The Commission noted CP67-08, including the Output Monitoring Group's report for March 2008. The Director of Investment also provided an oral update on Scottish Water's most recent investment activity.

The Commission emphasised the importance of measuring progress based on the number of projects that had been 'signed-off' by the quality regulators. The Commission will only consider an output to be delivered when it is signed off by the relevant quality regulator. This will be the basis of the Commission's assessment of progress in the 2007-08 Investment Report which is due for publication in the autumn of this year.

Action Point: Director of Investment to increase the frequency of meetings with SEPA and DWQR to emphasise the importance of sign-off progress. Update to be provided at next Commission meeting.

6.3 Update on leakage/leakage target for 2008-09

The Commission considered Scottish Water's leakage target for 2008-09 which would be included as a measure in the Commission's Overall Performance Assessment for Scottish Water.

The Commission agreed to set a leakage target range for 2008-09 of 825 to 855Ml/day with the mid-point of 840Ml/d being used for OPA purposes. The Commission emphasised that the calculation of leakage reduction to be used in establishing performance against the target must be based on a 'like-for-like' comparison with previous years.

The Commission noted Scottish Water's proposal to link leakage performance to the bonuses of its senior management. The Commission welcomed this proposal to incentivise Scottish Water's staff to achieve leakage targets. It viewed this as important given Scottish Water's failure to meet its targets in 2006-07 and 2007-08.

7. Financial

7.1 Update on Ministers' Principles of Charging (CP69/08)

The Commission noted that the Scottish Government would shortly publish its response to its 'Principles of Charging' consultation. The Commission recognised the importance of the Ministers' statement on

charges to its review of Scottish Water's charges for 2010-14. The Commission also emphasised the importance of the Ministers' statement clarifying the remit of the Commission independently to determine price caps.